July 10, 2025

H.R. 1: The "One Big, Beautiful Bill" - Unpacked

H.R. 1, the One Big Beautiful Bill Act, makes many of 2017 The Tax Cut and Jobs Act (TCJA) tax law changes permanent. It also adds some temporary and permanent changes to the tax code.

New Federal Tax Brackets for Individuals and Couples

- Permanently extends the lower individual income tax rates and thresholds from TCJA, currently scheduled to expire after 2025.
- Provides an extra inflation adjustment to the bottom six brackets (not the top bracket), which results in lower tax bills for those taxpayers.

For Single Fillers

TABLE 1. 2026 FEDERAL TAX RATES AND BRACKETS FOR SINGLE TAXPAYERS, TCJA EXPIRATION VS. HOUSE REPUBLICAN TAX BILL

	Current Law (TCJA Expires)		House Republican Tax Bill	
	Rate	Taxable Income at Which Rate Begins	Rate	Taxable Income at Which Rate Begins
1st Bracket	10%	$0	10%	$0
2nd Bracket	15%	$12,150	12%	$12,375
3rd Bracket	25%	$49,300	22%	$50,275
4th Bracket	28%	$119,400	24%	$107,200
5th Bracket	33%	$249,100	32%	$204,700
6th Bracket	35%	$541,550	35%	$259,925
7th Bracket	39.6%	$543,800	37%	$639,275

Source: https://bipartisanpolicy.org/explainer/whats-in-the-2025-house-republican-tax-bill/

For Married Filing Jointly

TABLE 2. 2026 FEDERAL TAX RATES AND BRACKETS FOR MARRIED TAXPAYERS, TCJA EXPIRATION VS. HOUSE REPUBLICAN TAX BILL

	Current Law (TCJA Expires)		House Republican Tax Bill	
	Rate	Taxable Income at Which Rate Begins	Rate	Taxable Income at Which Rate Begins
1st Bracket	10%	$0	10%	$0
2nd Bracket	15%	$24,300	12%	$24,750
3rd Bracket	25%	$98,600	22%	$100,550
4th Bracket	28%	$199,000	24%	$214,400
5th Bracket	33%	$498,200	32%	$409,400
6th Bracket	35%	$541,550	35%	$519,850
7th Bracket	39.6%	$611,750	37%	$767,150

Source: https://bipartisanpolicy.org/explainer/whats-in-the-2025-house-republican-tax-bill/

Standard Deduction Increases

- Permanently extends the doubled standard deduction from TCJA, currently scheduled to revert to approximately half its current amount after 2025.
- Provides an extra inflation adjustment to the standard deduction, which results in lower tax bills for taxpayers taking the standard deduction.

TABLE 3. 2025-2026 STANDARD DEDUCTION, TCJA EXPIRATION VS. HOUSE REPUBLICAN TAX BILL

	Filing Status	Current Law (TCJA Expires)	House Republican Tax Bill
2025	Single	$15,000	$16,000
	Married	$30,000	$32,000
2026	Single	$8,300	$16,550
	Married	$16,600	$33,100

Source: https://bipartisanpolicy.org/explainer/whats-in-the-2025-house-republican-tax-bill/

- Adds $1,000 to the standard deduction for single taxpayers and $2,000 for married couples from 2025-2028, which results in lower tax bills for taxpayers taking the standard deduction.

Pass-Through Deduction Expansion (QBI)

- Permanently extends the 20% deduction—and expands it to 23%—for pass-through business income from TCJA, currently scheduled to expire after 2025. This deduction is also referred to as 199A or the qualified business income (QBI) deduction.
- Eases the rules that limit the deduction for high-income taxpayers.
- Adds a category of eligible income for the deduction, qualified business development company interest income.

Estate Tax Exemption Extended

- Permanently extends a higher estate tax exemption from TCJA, currently scheduled to expire after 2025.
- Sets the exemption at $15 million in 2026, adjusted for inflation thereafter.

This effectively eliminates estate tax liability for the vast majority of American families, especially benefitting family farms and small business owners.

Alternative Minimum Tax (AMT) Reforms

- Permanently extends the higher AMT exemption amounts and thresholds from TCJA, currently scheduled to revert to much lower amounts after 2025 (i.e., subjecting more income to the AMT).
- Resets the base year upon which inflation adjustments are made, from 2017 to 2025, reducing AMT relief relative to TCJA extension.

No Tax on Tips

- Adds a deduction for qualified tips from 2025 through 2028.
- There is no limit on the amount of the deduction, though the deduction is generally limited to occupations that the Treasury Secretary certifies "traditionally and customarily" received tips before 2025. The deduction is also not available for taxpayers making above $160,000 in 2025, adjusted for inflation in future years.
- The tips deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions.

Senior Tax Deduction Expansion

- Creates an additional standard deduction for taxpayers over 65 from 2025 through 2028.
- The deduction is equal to $6,000 per individual and phases out at a 4% rate for single taxpayers making above $75,000 and married taxpayers making above $150,000.
- The senior deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions.

No Tax on Auto Loan Interest

- Creates a new deduction for certain auto loan interest from 2025 through 2028.
- The deduction is limited to $10,000 overall and phases out at a 20% rate for single taxpayers making above $100,000 and married taxpayers making above $200,000.
- The deduction only applies to vehicles that are completed (i.e., assembled) in the U.S.
- The auto loan deduction is available whether a taxpayer takes the standard deduction or itemizes their deductions.

Clean Energy Tax Overhaul

- The clean vehicle credit has been eliminated for electric vehicles purchased after September 30, 2025. If you bought an electric vehicle before this date, you may be eligible for a clean vehicle credit up to $7,500 for a new EV or $4,000 for a used EV.
- Energy efficient credits for home improvements under the Inflation Reduction Act will end for property placed in service after 2025. You can still claim these credits for improvements made in 2025 on your 2025 taxes (i.e. the ones you file in 2026), but this will be the last year they're available.

State and Local Tax (SALT) Deduction Expanded

H.R. 1 raises the cap on **State and Local Tax (SALT) deductions:**

- Extends TCJA's $10,000 SALT cap, but adds a new, larger cap for certain taxpayers described below.
- The new cap is $40,000, effective 2025, and phases down at a 30% rate for individuals making over $500,000.
- Increases $40,000 and $500,000 amounts by 1% each year from 2026 through 2033.
- Applies new limits to SALT deductions for pass-through businesses, partially overturning 2020 guidance from the IRS that allowed for SALT pass-through workarounds (though continuing to allow workarounds for certain types of businesses).
- Counts charitable payments to states—those made in efforts to work around the SALT cap—towards the SALT cap if the credit the taxpayer receives back for payment is greater than or equal to 25%.

Conclusion: A Comprehensive Overhaul with Broad Impacts

H.R. 1, the "One Big, Beautiful Bill," lives up to its name in scope and ambition. While it provides notable tax relief for middle-income earners, seniors, and small businesses, it also makes significant structural changes — such as the expanded estate tax exemption and clean energy credits — that will reshape the U.S. tax landscape for years to come. Whether you're a business owner, retiree, employee, or investor, this legislation likely affects your bottom line. As with any major reform, its success will be measured not only by reduced tax bills but also by its impact on economic growth, fairness, and long-term fiscal responsibility.

PROCYON

July 8, 2025

EQUITY INSIGHT

LATE CYCLE, EARLY SIGNALS: WHERE CAUTION MEETS OPPORTUNITY

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- Equity markets are progressing through a late-cycle disinflationary slowdown, but moderating inflation and stable financial conditions point to a potential inflection toward early recovery, creating renewed opportunities for selective risk-taking.

- Central banks are maintaining steady policy rates while markets increasingly price in forthcoming rate cuts, reflecting optimism for a soft landing as inflation pressures ease and policy credibility improves.

- S&P 500 earnings remain resilient, with technology and innovation-driven sectors leading growth. Recent analyst caution may set the stage for positive earnings surprises if macro conditions stabilize.

- Our Composite Risk Indicator has retreated from recent highs, now residing in the upper end of its neutral zone—suggesting reduced tail risks and a constructive, though selective, backdrop for large-cap equities.

- Historical regime analysis supports a tilt toward quality and growth, while ongoing monitoring of macro and risk indicators remains essential for capturing upside in an evolving late-cycle environment.

Monetary Conditions: Stability on the Surface, Turbulence Beneath

In July 2025, the monetary policy landscape appears deceptively calm, with the Federal Reserve holding its benchmark rate steady at 4.25%–4.50% and central banks in Europe and Japan similarly pausing or moving cautiously. But beneath the surface, financial markets and policymakers are navigating an increasingly fractured environment. Sticky core inflation, modest economic growth, and simmering geopolitical uncertainties continue to complicate the path ahead. While market participants increasingly price in a pivot toward easing—evidenced by a downward-sloping SOFR curve and elevated rate-cut expectations—the inflation trend remains mixed, particularly in core services. More than ever, monetary policy operates through a multidimensional lens. This month, the Fed not only maintained rates but also eased the pace of its Treasury runoff, signaling a nuanced adjustment to financial conditions without formally cutting rates. Meanwhile, updated economic projections reveal a classic policy conundrum: inflation is too high for comfort, yet growth and labor markets are weakening. In this context, tools like the Taylor Rule and market-based forward curves serve as guideposts to assess whether policy is appropriately calibrated—or increasingly disconnected from fundamentals. The following table distills the latest key indicators shaping this debate, from inflation trends and implied policy rates to balance sheet dynamics and long-run neutral rate estimates.

Figure 1. Monetary Indicators – July 2025

Indicator	Latest Value	Trend / Commentary
Federal Funds Target Rate	4.25% - 4.50%	Held steady for fourth consecutive meeting
Implied Rate (12M SOFR Futures)	3.75%	Markets expect ~50-75bps of easing by mid-2026
Core PCE Inflation (YoY)	3.10%	Elevated but trending down slowly
Headline CPI (YoY)	3.30%	Decelerating from early 2024 highs
Unemployment Rate	4.00%	Rising modestly; still below recessionary levels
GDP Growth (YoY)	1.40%	Softening; downward revision in Fed SEP
Output Gap (Real GDP vs Potential)	-0.50%	Modest slack in economy persists
10Y Treasury Yield	4.30%	Fallen ~40bps since Q1; signals easing pressure
Policy Rate Implied by Taylor Rule	3.45%	Suggests policy is modestly restrictive
Fed Balance Sheet (Total Assets)	$7.3T	QT slowed: Treasury runoff reduced to $5B/month

Source: Federal Reserve

Interpreting the Signals: What the Indicators Reveal About the Path Ahead

The metrics in the table above offer a multidimensional snapshot of the current monetary landscape—one that is rich with nuance and policy tension. The Fed Funds Rate remains elevated at 4.25%–4.50%, yet real rates (adjusted for core PCE inflation) are now meaningfully positive, signaling a restrictive stance by historical standards. The Taylor Rule, often cited for its quantitative rigor, suggests that the policy rate should already be closer to 3.25%–3.50%, depending on the assumptions about the natural rate of interest and the output gap. This divergence reinforces the view that the Fed may be erring on the side of caution—perhaps reflecting concern over inflation persistence or a desire to rebuild credibility after the late start to tightening in 2021–2022. Balance sheet policy adds another layer of complexity. The Fed's decision to taper Treasury runoff to $5 billion/month (while keeping MBS runoff unchanged) subtly eases financial conditions without triggering the optics of a full pivot. Meanwhile, market-based indicators—such as SOFR futures and the implied forward rate path—continue to anticipate rate cuts beginning as early as Q4 2025. This growing gap between "what the Fed says" and "what markets price" heightens the risk of volatility if data surprises to the upside or if policy inertia persists longer than anticipated. Ultimately, this table underscores that monetary policy is no longer just about interest rates—it's about managing expectations, navigating tradeoffs, and balancing credibility with flexibility in an increasingly uncertain environment.

Monetary Policy at a Crossroads: Politics, Data, and Market Assumptions

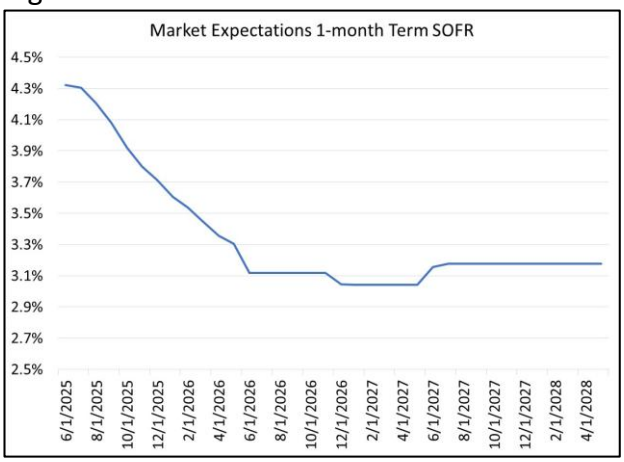
As we enter the second half of 2025, the direction of U.S. monetary policy sits at a precarious intersection—where economic data, political influence, and market expectations collide. While the Federal Reserve maintains a cautious "higher for longer" stance, markets have increasingly priced in an easing cycle, anticipating softening inflation and labor market conditions. However, this optimism exists alongside rising political pressure, including public calls for a change in Fed leadership, and the upcoming election cycle could further tilt policy bias toward accommodation. Importantly, models such as the Taylor Rule—which translates inflation and output gap data into a normative interest rate—now suggest that the Fed funds rate should be roughly 100 basis points lower than its current target range. This implies that the Fed may be overly tight given current macro conditions. Meanwhile, SOFR futures reflect aggressive easing expectations, highlighting a sharp divergence between market-implied policy paths and official Fed guidance.

This disconnect poses risks: either markets are too optimistic, or the Fed will eventually be forced to pivot, potentially against a still-sticky inflation backdrop. This section examines these competing narratives and assesses their implications for asset pricing and macro stability.

Market Pricing vs. Inflation Reality

Markets are increasingly convinced that the Fed will deliver rate cuts in the coming quarters, as reflected in the sharp downward slope of Fed Funds Futures and the SOFR forward curve. This pricing reflects expectations of a soft landing, with inflation continuing to cool and growth remaining resilient enough to avoid recession. However, the inflation story is far from settled. While headline CPI has moderated, core and sticky measures of inflation—especially in services—remain persistently elevated, raising the risk that market optimism may be premature. The juxtaposition of these two forces—market-implied easing vs. sticky inflation data—creates a policy tension that could constrain the Fed's ability to cut rates as aggressively as markets expect. The following chart highlight this divergence, illustrating the gap between investor assumptions and inflation's underlying market-based instruments—such as the Fed Funds futures and the SOFR forward curve—are currently pricing in several rate cuts through late 2025, signaling that markets expect inflation to soften enough to ease policy. The SOFR curve, derived from SOFR futures and bootstrapped, effectively reflects what traders believe the Fed will do in the months ahead.

Figure 2. SOFR Forward Curve



Source: Pensford

The divergence between market expectations, as reflected in the SOFR forward curve and Fed funds futures, and the persistence of sticky inflation underscores a critical tension for monetary policymakers. Markets, driven by futures and swap pricing, are currently pricing in rate cuts starting later this year—implying a belief that inflation is firmly on the descent and the Fed will align policy accordingly.

Yet headline and core "sticky-price" inflation measures remain elevated—sticky CPI sits around 3.2 % year-over-year, while even trimmed-mean and core variants stubbornly hover near 2.8–3.0 %. This mismatch between what markets are betting and the underlying inflation trajectory sets up a policy quandary: should the Fed lean into market optimism or stay cautious until inflation cools more convincingly?

Determining the appropriate interest rate for an economy is a complex endeavor, influenced by a range of macroeconomic variables and dependent on numerous underlying assumptions.

The Taylor Rule remains one of the most respected and enduring frameworks for guiding monetary policy decisions. Developed by economist John B. Taylor, it offers a systematic, quantitative approach to estimating the appropriate level of the policy interest rate based on prevailing economic conditions. Specifically, it anchors the nominal rate to the neutral real interest rate, current inflation relative to target, and the output gap—thereby integrating inflation control and economic stabilization into a single formula. Its strength lies in its transparency and consistency: unlike market narratives or political pressure, the Taylor Rule provides a rules-based benchmark grounded in macroeconomic fundamentals. Especially in periods of policy uncertainty, it serves as a valuable reference point for assessing whether current monetary policy is appropriately calibrated or veering too loose or too tight.

The Taylor Rule equation calculates what the federal funds rate should be, as a function of the output gap and current inflation:

$$r_t = r^* + \pi_t + 0.5(\pi_t - \pi^*) + 0.5(y_t - y^*)$$

Where:

- r_t: Implied nominal policy rate
- $r^* = 0.5\%$: Neutral real interest rate (Fed's long-run estimate)
- $\pi_t = 3.3\%$: Current inflation (YoY CPI)
- $\pi^* = 2.0\%$: Inflation target
- $y_t - y^* = -0.5\%$: Output gap (GDP is 0.5% below potential)

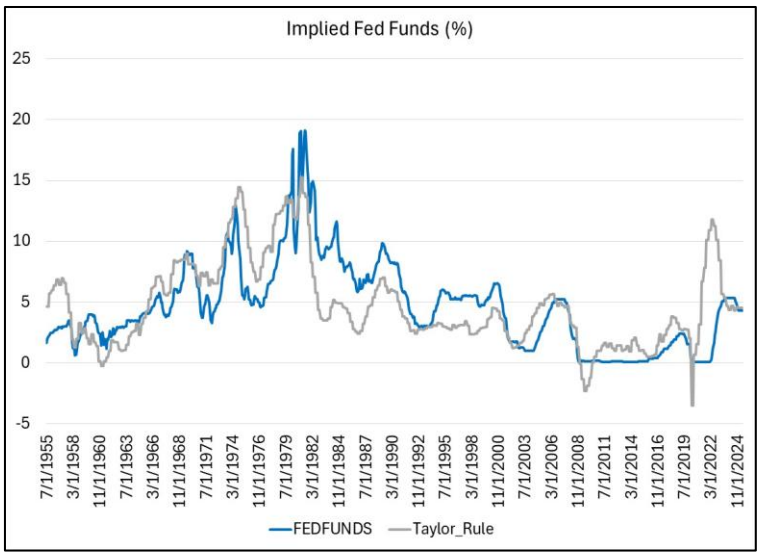
If the Fed strictly followed the Taylor Rule today, the federal funds rate would be around 4.20%, which is slightly below the current 4.25–4.50% target range.

This suggests that the Fed may still be tighter than fundamentally necessary based on inflation and output data alone, possibly due to concerns over inflation persistence, geopolitics, or financials stability risks.

Empirical research has shown that the natural rate of interest - the real interest rate expected to prevail when the economy is operating at its full sustainable level – has been steady declining since the 1960s (Figure 4).

The natural rate of interest (often called r*) is crucial because it serves as a benchmark for monetary policy—

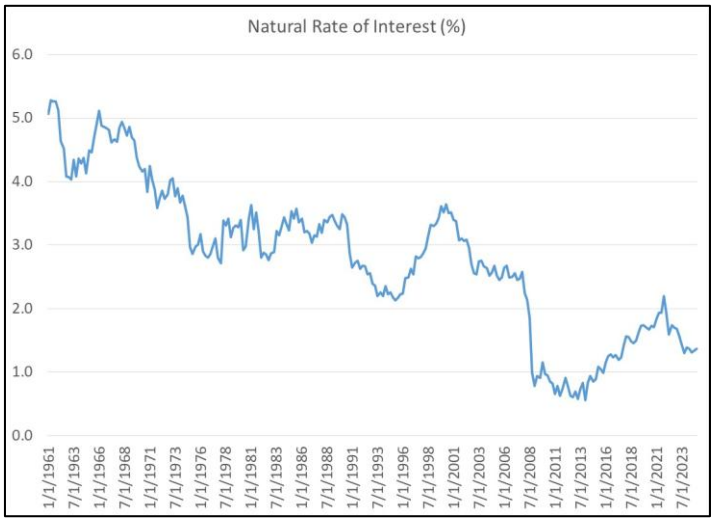
Figure 3. Taylor Rule and Fed Funds



Source: Federal Reserve

indicating the theoretical short-term real interest rate that is consistent with full employment and stable inflation when the economy is neither overheating nor underperforming. This rate is used for policy calibration, as the Fed compares the actual real interest rate (policy rate minus inflation) to r*. If the real rate is above r*, policy is restrictive. If it's below r*, policy is accommodative. With today's r* around 0.75% and real Fed Funds at about 1%, monetary policy seems marginally restrictive – suggesting a slight disinflationary stance.

Figure 4. Natural Rate of Interest Estimate



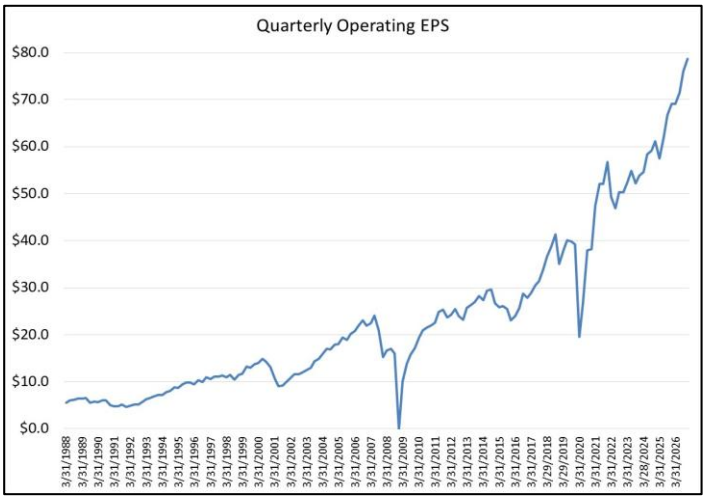
Source: Federal Reserve

Earnings Outlook: Momentum Beneath the Surface

As markets press higher, the earnings landscape presents a nuanced picture—one where headline strength masks growing divergences. While overall EPS levels remain near record highs, forward momentum has softened, with the EPS Revision Index trending sideways in recent months.

Beneath the surface, a persistent bifurcation remains: the "Magnificent 7" continue to dominate earnings growth, while the broader S&P 493 struggles to regain footing.

Figure 5. S&P 500 Operating EPS (2025-2026 estimates)

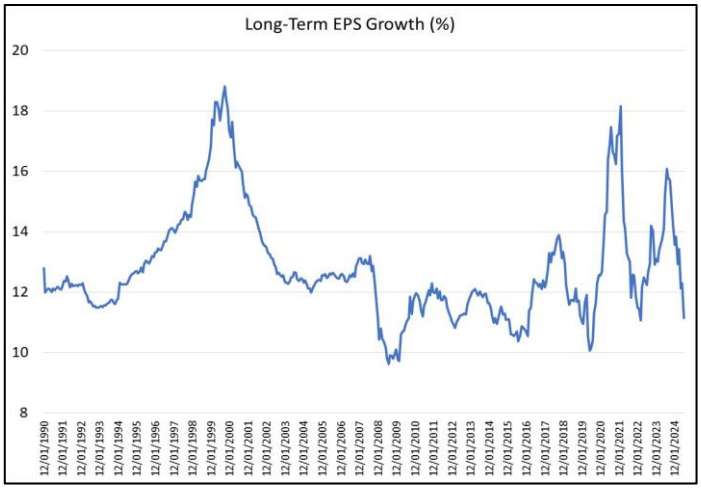


Source: S&P/Dow

Figure 6 below stands in contrast with Figure 5, as it shows a sharp drop in projected long-term EPS growth coinciding with the tariff announcement.

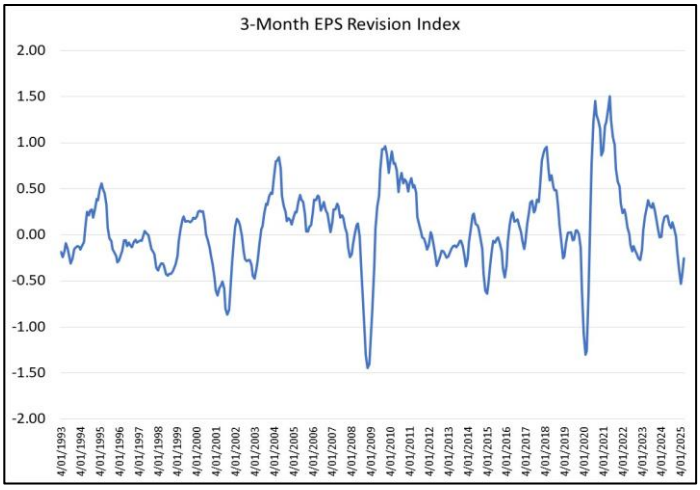
This recent sharp decline in long-term EPS growth expectations, may paradoxically be a bullish contrarian signal. Historically, when analysts' growth projections fall sharply—such as during trade shocks, policy uncertainty, or global economic scares—market pessimism often overshoots fundamentals. This pattern is evident in the chart: EPS growth estimates tend to peak above 15–16% ahead of market tops, often reflecting overly optimistic sentiment that fails to materialize. Conversely, troughs in growth expectations, especially in the 10–11% range, have historically coincided with market bottoms or strong forward returns, as investor sentiment is already washed out and valuations have reset. The latest dip, driven by analyst reactions to the April 2025 tariff announcements and renewed inflation concerns, suggests that sentiment is currently cautious—not euphoric—despite resilient fundamentals in many sectors. If past patterns hold, this pessimism could set the stage for positive earnings surprises and equity upside, particularly if macroeconomic conditions stabilize or companies prove more adaptable than expected. The Earnings Revision Index —defined as the net ratio of upward revisions to total analyst estimates—recently turned negative, reflecting a broad trend of downward earnings adjustments (Figure 7). However, the index has since rebounded, suggesting a shift in analyst sentiment as improved visibility into corporate earnings prompts upward revisions. This rebound often precedes an inflection in earnings momentum, underscoring greater alignment between macro conditions and forward guidance.

Figure 6. Consensus Forecast of Long-Term EPS Growth



Source: FactSet

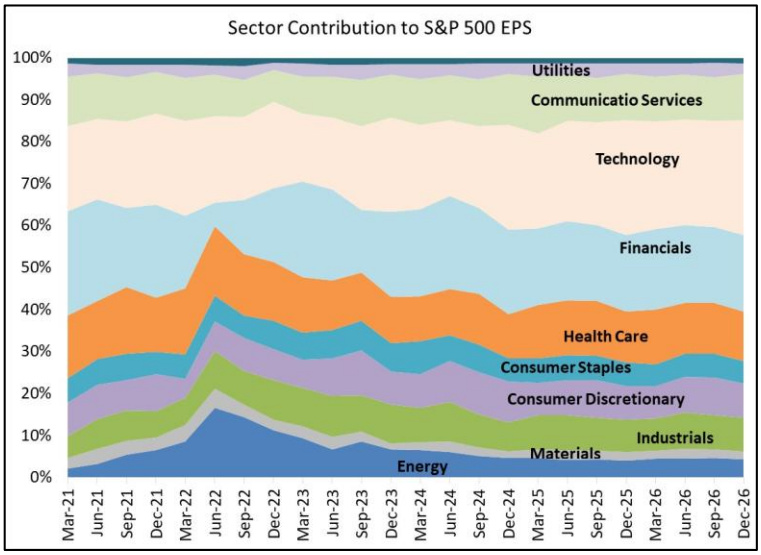
Figure 7. Earnings Revision Index – S&P 500



Source: FactSet

The Technology sector is projected to increase its contribution to the S&P 500's EPS from an average of about 20% in 2021 to over 25% by 2026. Earnings growth over the next several years is expected to be underpinned by a powerful convergence of innovation, capital investment, and structural demand.

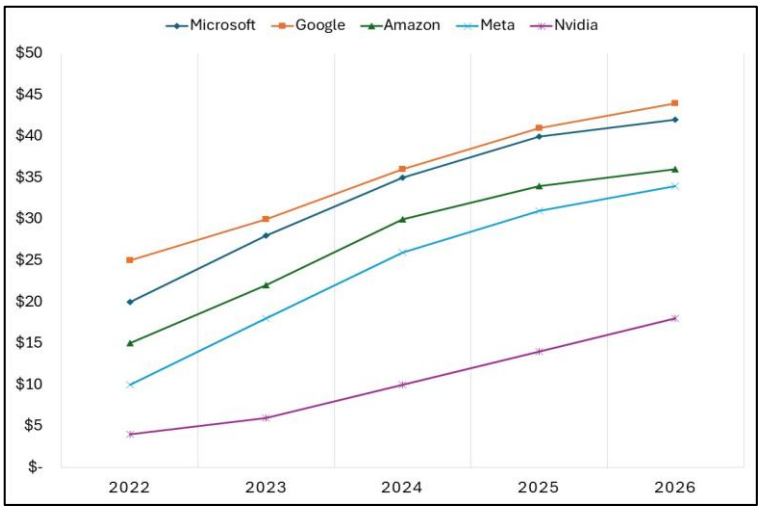
Figure 8. Sector Contribution to S&P 500 EPS



Source: S&P/Dow

The most significant driver is the ongoing wave of investment in generative AI infrastructure, with major players like Microsoft, Amazon, and Google expected to collectively exceed $200 billion in capital expenditures in 2025 alone (Figure 9). This spending surge is fueling robust demand across semiconductors, hyperscale data centers, and cloud software platforms.

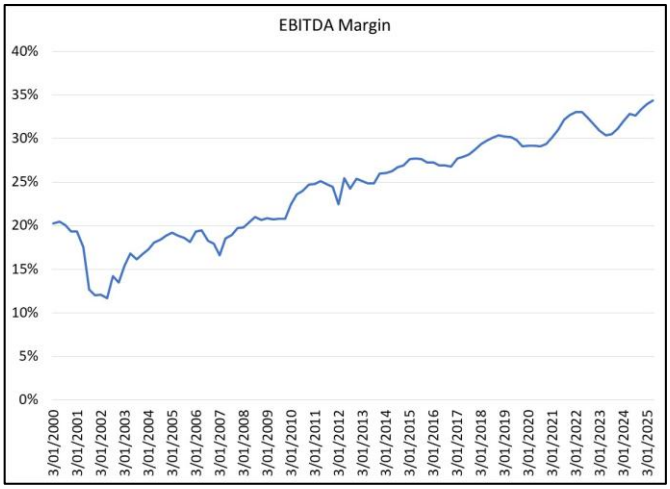
Figure 9. Estimated AI Capex By Company (2022-2026)



Source: Bloomberg, Company Guidance

At the same time, the focus is shifting from generalized AI models to industry-specific agents that solve domain-level problems in healthcare, finance, and cybersecurity—opening new monetization pathways. Cloud adoption remains a secular trend, with hybrid and edge computing supporting both topline growth and margin stability through recurring revenues. Moreover, many tech companies are entering this phase of expansion with improved operating efficiency, having tightened cost structures since 2022, creating favorable conditions for earnings leverage (Figure 10). Additional tailwinds include growing global digitization, continued enterprise demand for cybersecurity and automation, and an upcoming AI-powered hardware upgrade cycle in personal computing and devices. Taken together, these dynamics point to a sustained earnings upcycle that is both innovation-led and operationally disciplined—cementing Technology as a central pillar of forward-looking equity market performance.

Figure 10. Technology Sector EBITDA Margins



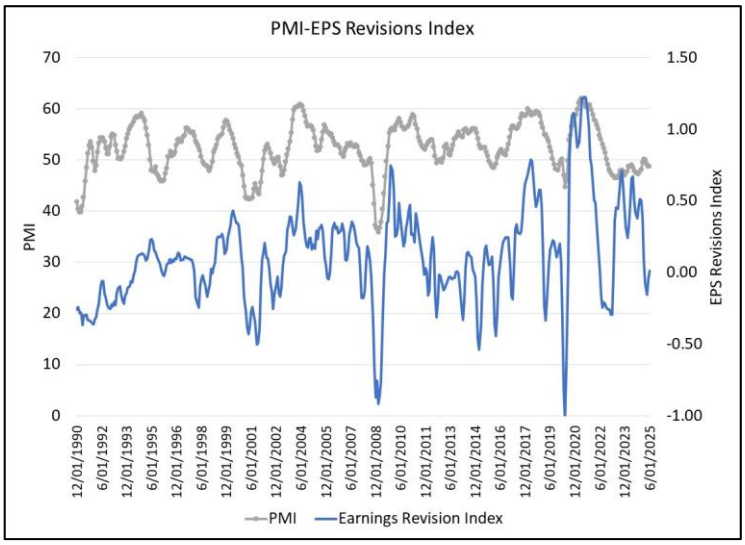
Source: FactSet

Mega-cap tech's outsized role in driving market returns and earnings growth has amplified concerns over narrow market breadth and the durability of current valuations. Historically, there has been a strong empirical relationship between forward EPS revisions and the Purchasing Managers' Index (PMI), a high-frequency gauge of cyclical demand. This linkage implies that additional upward revisions to corporate earnings may be constrained without a visible reacceleration in broader economic momentum. The next section delves into the links between the macroeconomic environment and corporate profitability cycles.

Business Cycle Assessment: PMI Regime, EPS Revisions, and Risk Dynamics

This section leverages our proprietary economic regime framework alongside the Equity Risk Indicator and Investment Clock to provide a high-frequency, forward-looking read on the macro-financial environment and its implications for equities. The combination of cyclical macro data and earnings revisions offers a granular view of market internals, sentiment, and fundamental momentum.

Figure 11. PMI and Earnings Revisions

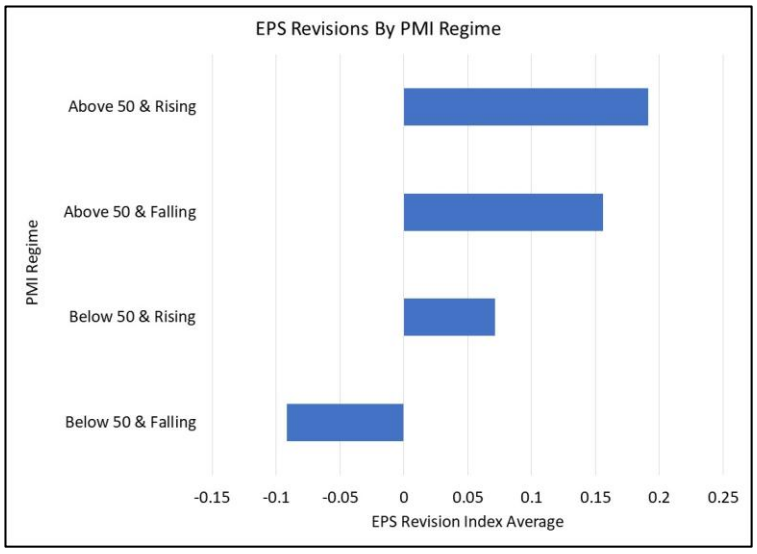


Source: FactSet, ISM

We begin with the PMI-EPS Revision Index overlay, which compares the ISM Manufacturing PMI (level and trend) with the 3-month moving average of S&P 500 EPS estimate revisions. The relationship between the ISM Manufacturing PMI and the three-month forward earnings revision index remains a powerful lens into how shifts in macroeconomic momentum filter through to market expectations. Historically, sustained declines in the PMI—particularly when it falls below the critical 50 level—coincide with mounting pessimism among analysts, often manifesting in a wave of downward EPS revisions. This reflects the weakening industrial and corporate activity that typically accompanies the later stages of the business cycle. The data confirm this dynamic: as PMI dips below 50, the EPS revision index tends to fall into negative territory, as analysts recalibrate earnings expectations to a slower or even contracting economic backdrop. These phases—like those witnessed in 2001, 2008, and again during the early COVID shock—have historically aligned with rising equity volatility and defensive investor positioning. At present, PMI readings below 50 suggest that the manufacturing economy is still in contraction, even as EPS revisions, while negative, appear to be bottoming. This divergence implies that while analysts are no longer aggressively cutting estimates, they are far from optimistic—a signal that aligns with late-cycle behavior, rather than an early recovery. From a market timing perspective, such environments often coincide with a transition phase: risk appetite is cautious, earnings momentum is subdued, but the worst of the downgrade cycle may be behind us.

In this context, the PMI-EPS revision interaction reinforces a "late slowdown" reading in the investment clock model. It underscores the importance of monitoring leading indicators (e.g., new orders or credit conditions) for signs of a bottoming in the cycle. Moreover, the subdued earnings sentiment could serve as a contrarian setup—history suggests that when EPS revisions are weak but improving, and PMI begins to inflect from sub-50 levels, equity markets tend to rally in anticipation of better fundamentals ahead.

Figure 12. PMI Regimes And EPS Revisions



Source: FactSet, ISM, Procyon Calculations

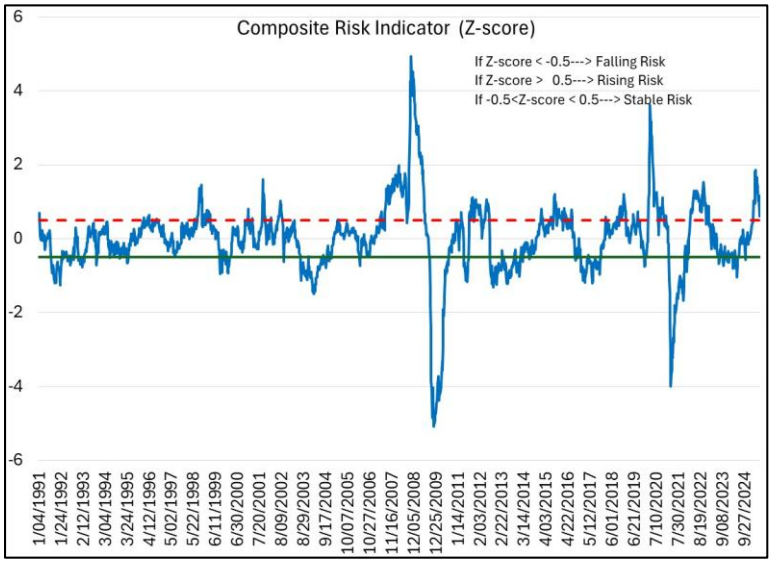
Business Cycle Assessment: Risk Dynamics

As of July 2025, the global market environment has shifted toward a risk-on/risk-neutral regime, with leading indicators such as VIX, NFCI, and credit spreads confirming improved risk sentiment despite ongoing late-cycle macro conditions. While PMIs and yield curves signal a slowdown phase and persistent inversion—classic late-cycle characteristics—US equities, led by the S&P 500 and technology, continue to outperform underlying fundamentals, bolstered by resilient growth and policy support.

Risk appetite is further validated by narrowing high-yield spreads, subdued volatility, and declining demand for safe-haven FX, all reflected in the composite risk indicator's decisive move out of risk-off territory. This shift has been catalyzed by central bank easing expectations and diminishing political risk, though volatility remains susceptible to macro shocks. Empirical backtests indicate that current risk indicator levels are historically consistent with positive forward returns for equities and credit, but with elevated sensitivity to regime reversals.

Figure 13 illustrates our Risk Composite Indicator, a composite index that blends macro volatility (such as inflation and rate dispersion), financial conditions (spreads and liquidity), and market-based sentiment (VIX, Gold/Copper ratio). As of July 2025, the indicator remains in the upper end of its neutral zone, having recently retreated from the elevated stress levels observed earlier this year. This pullback in risk pressure is noteworthy: it signals reduced tail risks, but not a broad-based risk-on environment. Such a regime is typically associated with low but gradually improving returns, especially for quality and large-cap growth equities with robust balance sheets. However, the model also highlights persistent policy uncertainty and tight financing conditions, which continue to weigh on small-cap and highly levered market segments. In sum, tactical allocation frameworks currently favor selective risk exposure, while maintaining vigilant regime monitoring given persistent late-cycle fragilities

Figure 13. The Composite Risk Indicator

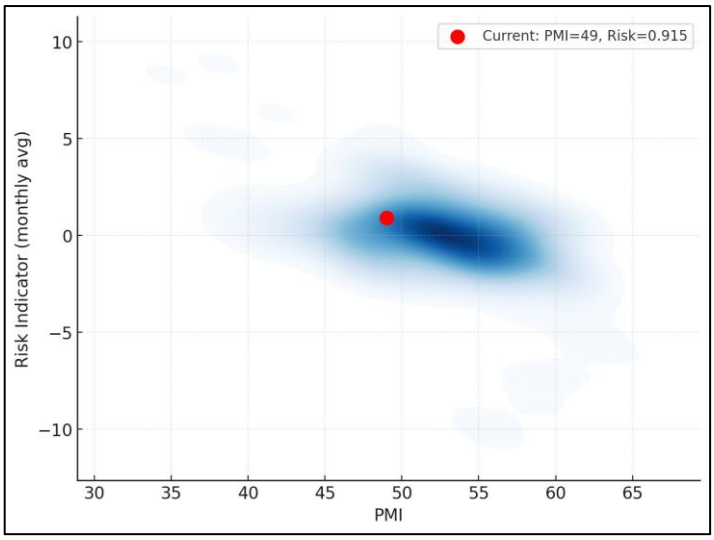


Source: Various Data Sources, Procyon Calculations

Visual Regime Analysis: Macro Signals in the PMI–Risk Space

The joint probability density plot of PMI versus the composite Risk Indicator (Figure 14) reveals several key features of the macro-financial regime landscape since 1991. Historically, the most densely populated region is centered around PMI values in the mid-40s to low-50s and risk indicator levels between -0.5 and +0.5, reflecting that the majority of observed environments have clustered in neutral-to-moderate macro and risk conditions.

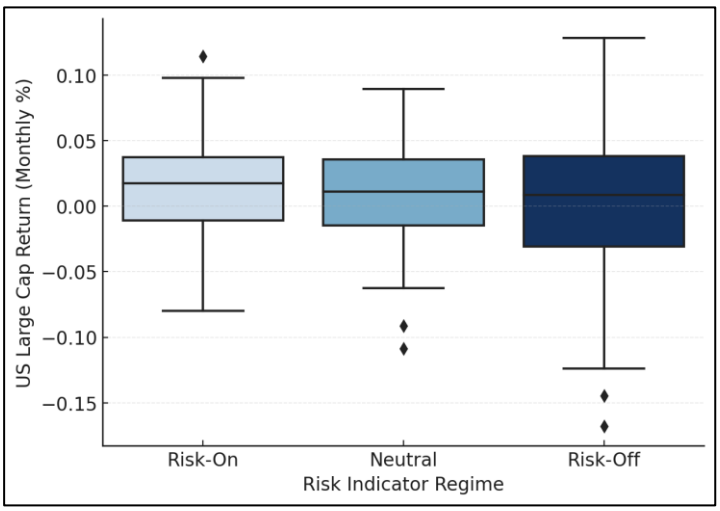
Figure 14. Joint Probability Plot PMI-Risk Indicator



Source: Various Data Sources, Procyon Calculations

This regime corresponds to late-cycle expansions, soft landings, or mild slowdowns—periods generally characterized by stable, though unspectacular, returns for quality assets and reduced tail risk. Notably, episodes of extreme stress (low PMI and high risk) or euphoria (high PMI and deeply negative risk) are rare, as evidenced by the sparse density at the plot's periphery. As of July 2025, the current environment is situated near the upper end of the historical density cluster, with PMI readings moderating in the low 50s and the risk indicator positioned just below its long-term mean. This aligns with a regime of reduced macro tail risk but without a broad-based risk-on backdrop, as corroborated by subdued volatility and tightening credit spreads. While history suggests that this zone typically offers stable but limited upside for equities and credit, persistent policy uncertainty and tight financing conditions continue to act as a constraint on more speculative or levered exposures, underscoring the tactical value of regime-aware asset allocation. The regime analysis from the joint probability plot finds direct expression in the distribution of US Large Cap equity returns across risk environments, as depicted in the accompanying boxplot (Figure 15). When the composite Risk Indicator is in the "Risk-On" regime—typically corresponding to PMI and risk levels near the historical density cluster—US Large Cap returns exhibit both a higher median and reduced downside, reflecting the improved macro and financial backdrop that has historically favored quality equity performance. In contrast, during "Risk-Off" periods, which correspond to excursions in the joint probability plot's low-density, high-risk regions, returns are not only lower on average but also display substantially greater negative skew and tail risk. The "Neutral" regime sits between these two extremes, consistent with its placement in the regime landscape. This relationship underscores the tactical value of regime-aware allocation: by aligning exposure with prevailing risk conditions as mapped in the joint probability space, investors can systematically tilt portfolios toward higher expected returns and reduced drawdowns, while maintaining vigilance for regime transitions that signal a shift in risk-reward dynamics.

Figure 15. US Large Cap Returns Distribution by Risk Regime (1991-2025)



Source: Various Data Sources, Procyon Calculations

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